



COMMISSIONER
TAX EXEMPT AND
GOVERNMENT ENTITIES
DIVISION

DEPARTMENT OF THE TREASURY
INTERNAL REVENUE SERVICE
WASHINGTON, D.C. 20224

201117047

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T: EP: RA: T3

LEGEND:

Company A:

LLC:

Plan X:

Dear

This letter is in response to a request for a ruling letter submitted on your behalf by your authorized representatives on May 12, 2009, as supplemented by letters dated January 6, 2010, and November 15, 2010, concerning whether certain transactions result in any individual becoming a disqualified person within the meaning of section 409(p) of the Internal Revenue Code ("Code"). Your authorized representatives have submitted the following facts and representations in support of this request.

Company A is an S corporation pursuant to its election on January 1, - LLC is a limited liability company which has as its principal business the performance, on a regular and continuing basis, of management functions for Company A. Your authorized representatives have represented that Company A and LLC are members of an affiliated service group within the meaning of Code section 414(m)(5) and are therefore treated as a single employer under the Code for all purposes germane to this ruling letter. Any reference in this ruling letter to employees of Company A includes employees of LLC.

Company A established Plan X effective January 1, for the benefit of its employees and the employees of any participating employer who satisfy Plan X's

eligibility and participation requirements. Plan X is a stock bonus plan which is intended to be qualified under Code section 401(a) and also to be an employee stock ownership plan ("ESOP") within the meaning of Code section 4975(e)(7). Company A maintains no other plan intended to be qualified under section 401(a) of the Code.

On December 22, Company A contributed cash to Plan X, which then acquired all of the shares of common stock of Company A from Company A's shareholders. All of the Company A common stock acquired by Plan X was allocated, in accordance with the terms of Plan X, for the plan year. Your authorized representatives have represented that this stock constitutes the only deemed-owned ESOP shares of Company A ("deemed-owned ESOP shares") within the meaning of Code section 409(p)(4)(C)(i) and section 1.409(p)-1(e) of the Income Tax Regulations ("regulations").

As an inducement to sell shares of Company A common stock to Plan X, Company A offered to sell warrants ("Warrant" or "Warrants") to purchase a specific number of additional shares of Company A common stock to the spouses ("Spouse" or "Spouses") of certain Plan X participants ("Subject Participants"). The Spouses propose to purchase these Warrants and exercise them with respect to all the shares of common stock subject thereto within 12 months following the date of purchase of such Warrants.

Your authorized representatives have represented that, other than Plan X and the Warrants, Company A does not maintain any type of plan that would confer such rights upon any individual so as to constitute synthetic equity, as defined in Code section 409(p)(6)(C) ("synthetic equity"). In addition, your authorized representatives have represented that Company A does not provide any remuneration for services under a plan or arrangement deferring the receipt of compensation, or any other remuneration that would be considered synthetic equity under section 1.409(p)-1(f)(iv) of the regulations.

Your authorized representatives have represented that no Plan X participant owns 10 percent or more of the deemed-owned ESOP shares within the meaning of section 1.409(p)-1(d)(1)(i) of the regulations and no Plan X participant owns any synthetic equity. None of the Spouses participates in Plan X. Your authorized representatives have represented that no Spouse will own 10 percent or more of the sum of the total number of deemed-owned ESOP shares and her own synthetic equity shares at any time within the meaning of section 1.409(p)-1(d)(1)(ii) of the regulations. Your authorized representatives have represented that no Plan X participants, other than the Subject Participants, have family members within the meaning of Code section 409(p)(4)(D) who own any employer securities or who have received any synthetic equity of Company A; none of the Subject Participants, together with their Spouses, will own 20 percent or more of the total number of deemed-owned ESOP shares within the meaning

of section 1.409(p)-1(d)(1)(iii) of the regulations; and none of the Subject Participants, together with their Spouses, will own 20 percent or more of the sum of the total number of deemed-owned ESOP shares and the synthetic equity shares owned by their Spouses within the meaning of section 1.409(p)-1(d)(1)(iv) of the regulations.

Based on the foregoing facts and representations, your authorized representatives have requested a ruling that none of (i) the proposed sale and issuance of the Warrants, (ii) the exercise of the Warrants, or (iii) the issuance of common stock upon exercise of the Warrants shall cause any holder of a Warrant or any other person to be treated as a disqualified person or result in a nonallocation year within the meaning of section 409(p) or the regulations promulgated thereunder.

Code section 409(p)(1) states that an employee stock ownership plan holding employer securities consisting of stock in an S corporation shall provide that no portion of the assets of the plan attributable to (or allocable in lieu of) such employer securities may, during a nonallocation year, accrue (or be allocated directly or indirectly under any plan of the employer meeting the requirements of section 401(a)) for the benefit of any disqualified person.

Code section 409(p)(3)(A) states that, for purposes of this subsection, the term "nonallocation year" means any plan year of an employee stock ownership plan if, at any time during such plan year, such plan holds employer securities consisting of stock in an S corporation, and disqualified persons own at least 50 percent of the number of shares of stock in the S corporation.

Code section 409(p)(3)(B) generally provides, with certain exceptions, that for purposes of determining a nonallocation year under section 409(p)(3)(A), the rules of section 318(a) shall apply for purposes of determining ownership.

Code section 409(p)(4)(A) states that the term "disqualified person" means any person if (i) the aggregate number of deemed-owned shares of such person and the members of such person's family is at least 20 percent of the number of deemed-owned shares of stock in the S corporation, or (ii) in the case of a person not described in clause (i), the number of deemed-owned shares of such person is at least 10 percent of the number of deemed-owned shares of stock in such corporation.

Code section 409(p)(4)(B) states that, in the case of a disqualified person described in subparagraph (A)(i), any member of such person's family with deemed-owned shares shall be treated as a disqualified person if not otherwise treated as a disqualified person under subparagraph (A).

Code section 409(p)(4)(C)(i) states that the term "deemed-owned shares" means, with respect to any person, (I) the stock in the S corporation constituting employer securities of an employee stock ownership plan which is allocated to such person under the plan, and (II) such person's share of the stock in such corporation which is held by such plan but which is not allocated under the plan to participants.

Code section 409(p)(4)(C)(ii) states that, for purposes of section 409(p)(4)(C)(i)(II), a person's share of unallocated S corporation stock held by such plan is the amount of the unallocated stock which would be allocated to such person if the unallocated stock were allocated to all participants in the same proportions as the most recent stock allocation under the plan.

Code section 409(p)(4)(D) states that, for purposes of section 409(p)(4), the term "member of the family" means, with respect to any individual, (i) the spouse of the individual, (ii) an ancestor or lineal descendant of the individual or individual's spouse, (iii) a brother or sister of the individual or individual's spouse and any lineal descendant of the brother or sister, and (iv) the spouse of any individual described in clause (ii) or (iii). Section 409(p)(4)(D) further states that a spouse of an individual who is legally separated from such individual under a decree of divorce or separate maintenance shall not be treated as such individual's spouse for purposes of this subparagraph.

Code section 409(p)(5) states in part that, for purposes of sections 409(p)(3) and (p)(4), in the case of a person who owns synthetic equity in the S corporation, except to the extent provided in regulations, the shares of stock in such corporation on which such synthetic equity is based shall be treated as outstanding stock in such corporation and deemed-owned shares of such person if such treatment of synthetic equity of one or more such persons results in (A) the treatment of any person as a disqualified person, or (B) the treatment of any year as a nonallocation year.

Code section 409(p)(5) further states that, for purposes of this paragraph, synthetic equity shall be treated as owned by a person in the same manner as stock is treated as owned by a person under the rules of paragraphs (2) and (3) of section 318(a). Section 409(p)(5) also states that if, without regard to this paragraph, a person is treated as a disqualified person or a year is treated as a nonallocation year, this paragraph shall not be construed to result in the person or year not being so treated.

Code section 409(p)(6)(C) defines synthetic equity, in part, to mean any stock option, warrant, restricted stock, deferred issuance stock right, or similar interest or right that gives the holder the right to acquire or receive stock of the S corporation in the future.

Section 1.409(p)-1(b)(1) of the regulations states that Code section 409(p)(1) provides that an ESOP holding employer securities consisting of stock in an S corporation must provide that no portion of the assets of the plan attributable to (or allocable in lieu of) such employer securities may, during a nonallocation year, accrue under the ESOP, or be allocated directly or indirectly under any plan of the employer (including the ESOP) meeting the requirements of section 401(a), for the benefit of any disqualified person.

Section 1.409(p)-1(c) of the regulations states in part that a year is a non-allocation year if it is described in the general definition in paragraph (c)(1) of this section.

Section 1.409(p)-1(c)(1) of the regulations provides in part that, for purposes of Code section 409(p) and this section, a "nonallocation year" means a plan year of an ESOP during which, at any time, the ESOP holds any employer securities that are shares of an S corporation and either (i) disqualified persons own at least 50 percent of the number of outstanding shares of stock in the S corporation (including deemed-owned ESOP shares), or (ii) disqualified persons own at least 50 percent of the sum of (A) the outstanding shares of stock in the S corporation (including deemed-owned ESOP shares) and (B) the shares of synthetic equity in the S corporation owned by disqualified persons.

Section 1.409(p)-1(d) of the regulations states in part that a person is a disqualified person if the person is described in paragraph (d)(1) or (d)(2) of this section.

Section 1.409(p)-1(d)(1) of the regulations states that, for purposes of Code section 409(p) and this section, a "disqualified person" means any person for whom –

- (i) the number of such person's deemed-owned ESOP shares of the S corporation is at least 10 percent of the number of the deemed-owned ESOP shares of the S corporation;
- (ii) the aggregate number of such person's deemed-owned ESOP shares and synthetic equity shares of the S corporation is at least 10 percent of the sum of (A) the total number of deemed-owned ESOP shares of the S corporation; and (B) the person's synthetic equity shares of the S corporation;
- (iii) the aggregate number of the S corporation's deemed-owned ESOP shares of such person and of the members of such person's family is at least 20 percent of the number of deemed-owned ESOP shares of the S corporation; or
- (iv) the aggregate number of the S corporation's deemed-owned ESOP shares and synthetic equity shares of such person and of the members

of such person's family is at least 20 percent of the sum of (A) the total number of deemed-owned ESOP shares of the S corporation; and (B) the synthetic equity shares of the S corporation owned by such person and the members of such person's family.

Section 1.409(p)-1(d)(2)(i) of the regulations states that each member of the family of any person who is a disqualified person under paragraph (d)(1)(iii) or (iv) of this section and who owns any deemed-owned ESOP shares or synthetic equity shares is a disqualified person.

Section 1.409(p)-1(d)(2)(ii) of the regulations provides definitions of the term "member of the family" for purposes of Code section 409(p) and this section and states in part that "member of the family" means, with respect to an individual, the spouse of the individual.

Section 1.409(p)-1(e)(1) of the regulations states that, for purposes of section 409(p) and this section, a person is treated as owning his or her deemed-owned ESOP shares. Deemed-owned ESOP shares owned by a person mean, with respect to any person, any shares of stock in the S corporation constituting employer securities that are allocated to such person's account under the ESOP.

Section 1.409(p)-1(f) of the regulations describes synthetic equity and sets forth applicable rules.

Under the facts and representations described above, the Warrants are synthetic equity within the meaning of Code section 409(p)(6)(C) and the only family members who are aggregated under the rules of section 409(p)(4)(D) are the Spouses. None of the Spouses participates in Plan X. In addition, the shares issued as a result of the exercise of the warrants are not deemed-owned shares.

Your authorized representatives have represented that no Plan X participant owns 10 percent or more of the deemed-owned ESOP shares within the meaning of section 1.409(p)-1(d)(1)(i) of the regulations; no Plan X participant owns any synthetic equity; and no Spouse will own 10 percent or more of the sum of the total number of deemed-owned ESOP shares and her own synthetic equity shares at any time within the meaning of section 1.409(p)-1(d)(1)(ii) of the regulations.

Your authorized representatives have represented that none of the Subject Participants, together with their Spouses, will own 20 percent or more of the total number of deemed-owned ESOP shares within the meaning of section 1.409(p)-1(d)(1)(iii) of the regulations. Your authorized representatives have represented that none of the Subject Participants, together with their Spouses, will own 20 percent or more of the sum of the total number of deemed-owned ESOP shares

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and the synthetic equity shares owned by their Spouses within the meaning of section 1.409(p)-1(d)(1)(iv) of the regulations.

Accordingly, with respect to your requested ruling, we conclude that none of (i) the proposed sale and issuance of the Warrants, (ii) the exercise of the Warrants, or (iii) the issuance of common stock upon exercise of the Warrants shall cause any holder of a Warrant or any other person to be treated as a disqualified person or result in a nonallocation year within the meaning of section 409(p) or the regulations promulgated thereunder.

Code section 409(p)(7)(B) states that the Secretary may, by regulation or other guidance of general applicability, provide that a nonallocation year occurs in any case in which the principal purpose of the ownership structure of an S corporation constitutes an avoidance or evasion of this subsection. This ruling letter expresses no opinion on any matters relating to this section.

This ruling letter is directed only to the taxpayer who requested it. Section 6110(k)(3) of the Code provides that it may not be used or cited by others as precedent.

A copy of this ruling letter has been sent to your authorized representative in accordance with a power of attorney on file with this office.

This ruling is based on the assumption that there is no synthetic equity within the meaning of Code section 409(p)(6)(C) and section 1.409(p)-1(f) of the regulations other than the Warrants.

This ruling letter is based on the assumption that Plan X is qualified under Code section 401(a) at all times relevant to the transaction described herein, and that Plan X is an ESOP as described in section 4975(e)(7).

If you wish to inquire about this ruling, please contact

ID #

Please address all correspondence to

SE:T:EP:RA:T3.

Sincerely,



Frances V. Sloan, Manager,
Employee Plans Technical Group 3

201117047

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Enclosures:

Deleted Copy of this Letter
Notice of Intention to Disclose

cc: